

VZCZCXRO0999
RR RUEHCN RUEHGH
DE RUEHBJ #2549/01 1670553
ZNR UUUUU ZZH
R 160553Z JUN 06
FM AMEMBASSY BEIJING
TO RUEHC/SECSTATE WASHDC 9168
INFO RUEHCN/AMCONSUL CHENGDU 6549
RUEHGX/AMCONSUL GUANGZHOU 0818
RUEHGH/AMCONSUL SHANGHAI 4958
RUEHSH/AMCONSUL SHENYANG 6362
RUEHHK/AMCONSUL HONG KONG 7649
RUEHIN/AIT TAIPEI 5719
RHEHNSC/NSC WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUEHGV/USMISSION GENEVA 1176
RUCPDOG/USDOC WASHDC

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STATE FOR EAP/CM, EB/TPP/BTA, AND EB/IFD/OIA
STATE PASS USTR FOR STRATFORD/CELICO/KEMP
TREASURY FOR OASIA/ISA
USDOC FOR 5101/ITA/IA
USDOC FOR 4220/ITA/MAC
USDOC FOR 1003/ITA/OUS
USDOC FOR 6310/ITA/TD/OIEM

E.O. 12958: N/A

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SUBJECT: CHINA: IS INDUSTRIAL OVERCAPACITY OVERWHELMING, OR
OVERHYPED?

11. (SBU) SUMMARY. THE CHINESE GOVERNMENT HAS IDENTIFIED SEVERAL INDUSTRIAL SECTORS AS SUFFERING FROM OVERCAPACITY. THE CENTRAL GOVERNMENT RECENTLY ISSUED REGULATIONS INTENDED TO ADDRESS THIS SITUATION OUT OF FEAR THAT THE OVERCAPACITY PROBLEM COULD IMPACT MACROECONOMIC STABILITY. THE REGULATIONS ARE INTENDED TO CONTROL OVERCAPACITY BY PROMOTING THE ELIMINATION OF OUT-OF-DATE PRODUCTION TECHNOLOGY, INCREASING INDUSTRY ENTRY STANDARDS, AND ENCOURAGING GREATER ENVIRONMENTAL PROTECTION. SOME ANALYSTS BELIEVE OBSTRUCTIONISM BY LOCAL GOVERNMENT OFFICIALS INTENT ON PRESERVING THEIR LOCAL INDUSTRIAL BASE COULD DERAIL THE CENTRAL GOVERNMENT'S EFFORTS. ADDITIONALLY, SOME EXPERTS ARE QUESTIONING WHETHER OVERCAPACITY REALLY EXISTS IN SOME SECTORS SUCH AS THE STEEL SECTOR. IN THE END, EXPERTS BELIEVE THAT IF THE CENTRAL GOVERNMENT EXPECTS RESULTS FROM ITS EFFORTS TO COMBAT THE PERCEIVED OVERCAPACITY PROBLEM, A SENIOR LEVEL WORKING GROUP MUST BE ESTABLISHED IN THE CENTRAL GOVERNMENT TO LEAD THE CHARGE. END SUMMARY.

SEVERAL INDUSTRIAL SECTORS ASSESSED AS THREAT TO
MACROECONOMIC STABILITY

12. (SBU) DR. SHI YAODONG, VICE-DIRECTOR OF THE STATE COUNCIL DEVELOPMENT RESEARCH CENTER'S (DRC) INDUSTRIAL ECONOMICS RESEARCH DEPARTMENT, SAID THAT THE NATIONAL DEVELOPMENT AND REFORM COMMISSION (NDRC) HAS IDENTIFIED SEVERAL INDUSTRIAL SECTORS AS POSSESSING EXCESS CAPACITY AND IS TAKING STEPS TO ELIMINATE THE OVERCAPACITY TO AVOID OVERHEATING THE ECONOMY. THE NDRC HAS DECIDED TO REIGN IN GROWING OVERCAPACITY IN THE STEEL, CEMENT, ALUMINUM, COKE, AND THE FERROUS ALLOY SECTORS. TO ILLUSTRATE THE OVERCAPACITY PROBLEM, DR. SHI SAID THAT RESEARCHERS ASSESS THAT THERE IS SOME 470 MILLION METRIC TONS OF STEEL PRODUCTION CAPACITY, BUT THERE IS ONLY AROUND 350 MILLION METRIC TONS OF DOMESTIC DEMAND. MEANWHILE, IN THE CEMENT SECTOR THERE IS SOME 300 MILLION METRIC TONS OF EXCESS CAPACITY. DR. SHI NOTED THAT MUCH OF THIS EXCESS CAPACITY IS GENERATED BY OUTDATED TECHNOLOGY THAT CONSUMES TOO MUCH ENERGY AND GENERATES EXCESSIVE

POLLUTION.

13. (SBU) NOTE: DR. SHI DEFINED OVERCAPACITY AS THE ABILITY OF A SECTOR TO OVERPRODUCE A GIVEN PRODUCT, BUT CAUTIONED THAT WHAT IS CONSIDERED OVERPRODUCTION CAPACITY CAN VARY BY SECTOR. FOR EXAMPLE, IN SOME SECTORS, SUCH AS TRANSPORTATION, USAGE RATES BELOW 85-90 PERCENT -- THAT IS, 10-15 PERCENT OF AVAILABLE CAPACITY IS NOT BEING UTILIZED -- SUGGESTS THAT THERE MAY BE AN OVERCAPACITY PROBLEM. IN OTHER SECTORS, UTILIZATION OR PRODUCTION RATES CAN BE AS LOW AS 70 PERCENT BEFORE RESEARCHERS ASSESS THERE IS A PROBLEM. DR. SHI ALSO NOTED THAT THERE IS NOT ALWAYS AGREEMENT ON WHAT USAGE RATE SIGNALS OVERCAPACITY PROBLEMS, CITING THE COAL SECTOR AS AN EXAMPLE WHERE THERE IS SOME DEBATE ON ITS STATUS. BY CONTRAST, CHINA'S FERROUS ALLOY SECTOR PRODUCTION RATE OF 50 PERCENT IS AN EXAMPLE WHERE THERE IS CLEAR AGREEMENT ON THE SECTOR'S INCLUSION IN THE OVERCAPACITY CAMP. END NOTE.

14. (SBU) DR. SHI STATED THAT THE CENTRAL GOVERNMENT MUST ADDRESS THE OVERCAPACITY PROBLEM BECAUSE IT IS POSING A TWOFOLD THREAT TO MACROECONOMIC STABILITY. FIRST, THERE IS A VERY CLEAR TENDENCY TOWARDS EXCESS INVESTMENT IN THESE SECTORS. AS AN EXAMPLE OF THIS PROBLEM, DR. SHI NOTED THAT DURING THE FIRST QUARTER OF 2006, IN SEVERAL OF THE OVERCAPACITY SECTORS, INVESTMENT IS SOME 30 PERCENT HIGHER THAN LAST YEAR DESPITE THE ALREADY CLEAR MISMATCH BETWEEN DEMAND AND SUPPLY. SECOND, THE PRICE LEVEL OF NATURAL RESOURCE INPUTS INTO THESE SECTORS, MAINLY ENERGY RESOURCES SUCH AS OIL, IS RAPIDLY INCREASING, WHICH IS PLACING INFLATIONARY PRESSURE ON THE ECONOMY, ACCORDING TO DR. SHI.

CENTRAL GOVERNMENT TRYING TO ADDRESS OVERCAPACITY...

BEIJING 00012549 002 OF 005

15. (SBU) DR. SHI SAID THAT IN MARCH AND APRIL 2006 THE NDRC AND OTHER RELEVANT CENTRAL GOVERNMENT DEPARTMENTS PROMULGATED SEVERAL REGULATIONS AS A FIRST STEP TO ADDRESSING THE CURRENT OVERCAPACITY PROBLEM. THE REGULATIONS ARE INTENDED TO CONTROL OVERCAPACITY BY PROMOTING THE ELIMINATION OF OUT-OF-DATE PRODUCTION TECHNOLOGY, INCREASING INDUSTRY ENTRY STANDARDS, AND ENCOURAGING GREATER ENVIRONMENTAL PROTECTION. DR. SHI STATED THAT THE REGULATIONS ARE NOT A CENTRAL GOVERNMENT ATTEMPT TO EXERT DIRECT CONTROL ON ENTERPRISES. RATHER, THE REGULATIONS ARE A PART OF A BASKET OF MEASURES THAT WILL RELY ON COOPERATION BETWEEN THE CENTRAL GOVERNMENT AND LOCAL OFFICIALS AS WELL AS BETWEEN DIFFERENT CENTRAL GOVERNMENT DEPARTMENTS.

16. (SBU) DR. SHI STATED THAT THE NEW CENTRAL GOVERNMENT REGULATIONS INTENDED TO FIGHT OVERCAPACITY PRIMARILY ADDRESS LAND MANAGEMENT, BANK LOANS, AND INDUSTRIAL SECTOR CONCENTRATION ISSUES. OFFICIALS FROM THE MINISTRY OF LAND MANAGEMENT STATED THAT THEIR OFFICE RECENTLY ISSUED A REGULATION, ENTITLED DOCUMENT NUMBER EIGHTY-EIGHT, THAT WILL ADDRESS LAND MISUSE BY THE COAL SECTOR THROUGH THE LINKAGE OF TAXATION RATES TO ENERGY UTILIZATION. THE MINISTRY INTENDS FOR THE REGULATION, WHICH IS CURRENTLY IN A TRIAL PHASE, TO PROMOTE BETTER UTILIZATION OF EXISTING MINES AND DISSUADE ABUSIVE LAND PRACTICES BY MINING COMPANIES.

17. (SBU) DR. SHI NOTED THAT ON THE BANK LOAN FRONT, THE CENTRAL GOVERNMENT INTENDS TO PLACE RESTRICTIONS ON LOAN AMOUNTS TO INDUSTRIAL CUSTOMERS. THE CENTRAL GOVERNMENT ALSO WILL ADJUST THE INTEREST RATE OF THE LOAN BASED UPON CERTAIN CRITERIA, MOST NOTABLY THE SIZE OF THE PROPOSED INDUSTRIAL PROJECT THE LOAN IS FUNDING. AS AN EXAMPLE OF THE CENTRAL GOVERNMENT'S GOALS ON THE INDUSTRIAL CONCENTRATION FRONT, DR. SHI STATED THAT THE NDRC AIMS TO HAVE THE TEN LARGEST CEMENT PRODUCERS ACCOUNTING FOR 30 PERCENT OF CHINA'S CEMENT PRODUCTION BY 2011. AT PRESENT, THERE ARE SOME 5,000 CEMENT ENTERPRISES IN CHINA WITH THE TEN LARGEST PRODUCERS ONLY ACCOUNTING FOR ABOUT 15 PERCENT

OF TOTAL PRODUCTION.

...BUT TODAY'S REGULATIONS JUST THE LATEST IN A SERIES

18. (SBU) DR. SHI STATED THAT THE JURY IS OUT ON HOW EFFECTIVE THE NEW REGULATIONS WILL BE AT CONTROLLING OVERCAPACITY. THE RECENT REGULATIONS ARE JUST THE LATEST IN A SERIES OF MOVES THAT HAVE ALTERNATIVELY SOUGHT TO PROMOTE GROWTH IN THE NOW OVERCAPACITY SECTORS AND THEN, SUBSEQUENTLY, REIN IN GROWTH. FOR EXAMPLE, DR. SHI SAID THAT IN 1998 THE CENTRAL GOVERNMENT ISSUED REGULATIONS TO PROMOTE THE GROWTH OF CERTAIN ENERGY-INTENSIVE SECTORS, SUCH AS ALUMINUM. AS A RESULT, THE ALUMINUM SECTOR RECEIVED PREFERENTIAL POWER AND WATER PRICING THAT ENABLED THAT SECTOR TO GROW. DR. SHI STATED THAT THE ALUMINUM SECTOR DID GROW, BUT NOT IN THE CONCENTRATED FORM THE CENTRAL GOVERNMENT SOUGHT. THE CENTRAL GOVERNMENT THEN ISSUED NEW REGULATIONS IN 2004 THAT SOUGHT TO ENCOURAGE MORE LARGE-SCALE PRODUCTION IN THE ALUMINUM AND OTHER ENERGY INTENSIVE INDUSTRIAL SECTORS. DR. SHI STATED THAT MANY OF THESE SMALL-TO-MEDIUM SCALE ALUMINUM ENTERPRISES ARE NOW CONSIDERED "BACKBONE ENTERPRISES" IN CERTAIN AREAS AND LOCAL GOVERNMENTS ARE RESISTING REGULATIONS THAT COULD DISLOCATE OR CLOSE THESE ENTERPRISES.

IMBY: PLANNERS STRUGGLE WITH "IN MY BACK YARD" SYNDROME

19. (SBU) DR. LU TIE, PROFESSOR AT THE INSTITUTE OF INDUSTRIAL ECONOMICS AT THE CHINESE ACADEMY OF SOCIAL SCIENCES (CASS) EMPHASIZED THAT THE KEY TO REINING IN OVERCAPACITY IS TO REPAIR THE RELATIONSHIP BETWEEN THE

BEIJING 00012549 003 OF 005

CENTRAL GOVERNMENT AND LOCAL GOVERNMENTS. THE CENTRAL GOVERNMENT HAS EMERGING ECONOMIC, LEGAL, AND ADMINISTRATIVE MEASURES TO COMBAT OVERCAPACITY, BUT LOCAL OFFICIALS HAVE MUCH GREATER INFLUENCE ON ECONOMIC DEVELOPMENT IN THEIR AREAS. LU STATED THAT LOCAL LEADERS ARE COMPETING TO PROMOTE INDUSTRIALIZATION TO GENERATE JOBS, TAX REVENUE, AND GDP GROWTH AND, AS A RESULT, ARE CREATING OVERCAPACITY AND ENVIRONMENTAL PROBLEMS. CENTRAL GOVERNMENT REGULATIONS ARE BEING MET BY RESPONSES FROM MOST PROVINCIAL AND LOCAL GOVERNMENTS THAT SUCH CONTROLS ARE APPLICABLE FOR OTHER AREAS, NOT THEIRS.

10. (SBU) DR. LU COMPARED LOCAL GOVERNMENT LEADERS TO MANAGERS OF A LARGE BUSINESS IN THAT THEY SQUARELY FOCUS ON PROFITS AND THE BOTTOM LINE. LOCAL GOVERNMENTS OFTEN DO NOT HAVE THE RESOURCES TO PROMOTE LARGE-SCALE PROJECTS SO THEY SEEK TO ENCOURAGE THE DEVELOPMENT OF MULTIPLE SMALL-TO-MEDIUM SCALE INDUSTRIAL ENTERPRISES TO FILL THE GAP. DR. LU STATED THE CENTRAL GOVERNMENT'S LONG-STANDING ECONOMIC THEORY IS THAT LARGE-SCALE INDUSTRIAL ENTERPRISES HAVE LOWER COSTS BECAUSE OF ECONOMIES OF SCALE. THE REALITY IN MANY PARTS OF CHINA IS QUITE DIFFERENT. MANY SMALL-TO-MEDIUM SIZED ENTERPRISES ARE MUCH MORE PROFITABLE BECAUSE OF PROTECTION FROM LOCAL GOVERNMENT LEADERS. THE RESULT IS THAT THESE INDUSTRIAL ENTERPRISES ARE ABLE TO SAVE MONEY BY FORGOING COSTLY OUTLAYS ON CENTRAL GOVERNMENT MANDATED ENERGY CONSERVATION OR ENVIRONMENTAL PROTECTION EFFORTS, ACCORDING TO DR. LU.

11. (SBU) DR. LU INDICATED THAT THE EVALUATION SYSTEM ON WHICH LOCAL GOVERNMENT OFFICIALS RELY FOR THEIR PROMOTION AND ADVANCEMENT IS THE CAUSE OF THIS PROBLEM. MOST LOCAL GOVERNMENT LEADERS UNDERSTAND THAT A CENTRAL GOVERNMENT PRIORITY DURING THE ELEVENTH FIVE YEAR PLAN IS TO PROMOTE POLICIES LEADING TO GREATER CONSUMER CONSUMPTION AND ENVIRONMENTAL PROTECTION. LOCAL GOVERNMENTS OFFICIALS ALSO ARE AWARE THAT DEVELOPING MORE ENVIRONMENTALLY FRIENDLY AND CONSUMPTION PRODUCING SECTORS, SUCH AS THE TOURISM AND SERVICE SECTORS, DOES LITTLE TO GENERATE TAX REVENUE. LU STATED THAT AS A RESULT, MANY LOCAL GOVERNMENT OFFICIALS REMAIN COMMITTED TO USING INDUSTRIALIZATION TO DRIVE LOCAL

ECONOMIC DEVELOPMENT AND GDP GROWTH. ECONOMIC PLANNERS
RECOGNIZE THIS DILEMMA AND ARE TAKING STEPS TO ADDRESS IT,
BUT IN DR. LU'S OPINION, THEY ARE OVERLY OPTIMISTIC THAT
THESE STEPS CAN SOLVE THE PROBLEMS IN A SHORT PERIOD.

EMERGING POWER SURPLUS ALSO A PROBLEM FOR PLANNERS

¶12. (SBU) DR. LU SAID THAT POWER GENERATION SURPLUSES THAT
SHOULD EMERGE IN 2007 WILL EXACERBATE LOCAL GOVERNMENT'S
PREDILECTION FOR ENCOURAGING INDUSTRIALIZATION. LOCAL
GOVERNMENTS AND POWER PLANTS WILL OFFER SIGNIFICANT REBATES
ON POWER PURCHASES BY INDUSTRIAL CUSTOMERS DURING THE NEXT
SEVERAL YEARS BECAUSE THE NEWLY CONSTRUCTED POWER PLANTS
WILL HAVE LOANS THAT THEY NEED TO PAYOFF. DR. LU SAID THAT
THIS MAY NOT BE A MAJOR PROBLEM IN EASTERN CHINA WHERE THE
WELL ESTABLISHED POWER GRID CAN BE EFFECTIVELY REGULATED BY
THE NDRC, ALTHOUGH SOME POWER PLANTS THERE MAY GIVE
PREFERENTIAL PRICES TO INDUSTRIAL ENTERPRISES BECAUSE THEY
ARE SUCH GOOD CUSTOMERS. DR. LU SAID THE PREFERENTIAL POWER
PRICING PRACTICE WILL BE MORE MANIFEST IN THE MIDDLE AND
WESTERN PARTS OF CHINA. THIS AREA HAS NEW POWER PLANTS,
MANY OF THEM OFF THE ESTABLISHED REGIONAL GRIDS, THAT WILL
BE COMPETING FOR THE BUSINESS OF SMALL-TO-MEDIUM SIZED
INDUSTRIAL CUSTOMERS, PARTICULARLY THAT OF THE LARGE NUMBER
OF FERROUS METAL SMELTING PLANTS LOCATED THERE.

¶13. (SBU) NOTE: DR. LU DURING THE DISCUSSION ON CHINA'S
POWER SITUATION SOUGHT TO REFUTE A STUDY THAT CALLED INTO
QUESTION CHINA'S GDP GROWTH RATE FROM 1997-2000 PUBLISHED IN
2001 BY AMERICAN RESEARCHER THOMAS RAWSKI. THE STUDY
ASSERTED THAT CHINA'S GDP WAS MOST LIKELY OVERSTATED BECAUSE

BEIJING 00012549 004 OF 005

THE RATE OF GDP GROWTH AND ENERGY CONSUMPTION WERE
UNCORRELATED. DR. LU STATED THAT RAWSKI UNDERESTIMATED
ENERGY CONSUMPTION BECAUSE OF HIS OVERRELIANCE ON DATA FROM
LARGE POWER PLANTS. THE STUDY FAILED TO PROPERLY ACCOUNT
FOR THE MANY SMALL-TO-MEDIUM SIZE POWER PLANTS IN CHINA THAT
CONTRIBUTE TO CHINA'S OVERALL POWER GENERATION AND RESULTING
ENERGY CONSUMPTION. DR. LU ALSO CLAIMED THAT THE STUDY
FAILED TO FACTOR IN THE PHENOMENON OF ENERGY AND POWER
PRODUCERS UNDERREPORTING THEIR PRODUCTION TO AVOID PAYING
TAXES, A PROBLEM THAT HE SAYS REMAINS TODAY. END NOTE.

FOR STEEL SECTOR AT LEAST, WORRIES MAYBE OVERWROUGHT

¶14. (SBU) YANG ZUNQING, DEPUTY SECRETARY GENERAL OF THE
CHINA IRON AND STEEL ASSOCIATION (CISA) SAID THAT THE
CENTRAL GOVERNMENT'S CONCERNS ABOUT OVERCAPACITY IN THE
STEEL SECTOR ARE MISPLACED. IN FACT, CHINA'S CURRENT STEEL
CAPACITY WILL BE INADEQUATE TO MEET RISING DOMESTIC DEMAND,
DESPITE PUBLIC STATEMENTS BY CENTRAL GOVERNMENT OFFICIALS TO
THE CONTRARY. CISA ESTIMATES THAT ACTUAL STEEL PRODUCTION
CAPACITY IS AROUND 415 MILLION METRIC TONS, VICE THE 470
MILLION METRIC TONS TOUTED BY THE NDRC, AND NOT ALL OF THIS
PRODUCTION CAPACITY IS AVAILABLE. YANG STATED THAT DURING
THE NEXT TWO TO THREE YEARS, THE CURRENT STEEL PRODUCTION
CAPACITY WILL MEET THE COUNTRY'S NEEDS THAT LAST YEAR WERE
ESTIMATED AT AROUND 350 MILLION METRIC TONS. BEYOND THAT
TIMEFRAME, CURRENT PRODUCTION CAPACITY WILL FAIL TO MEET
CHINA'S RISING DEMAND, ESTIMATED TO BE ANNUALLY INCREASING
AT AROUND 15 PERCENT.

¶15. (SBU) YANG SAID THAT TO MANAGE THE APPROACHING SUPPLY
PROBLEM, THE CENTRAL GOVERNMENT MUST CONTROL THE GROWTH OF
REAL ESTATE DEVELOPMENT AND NEW CONSTRUCTION, THE LARGEST
DRIVERS OF STEEL DEMAND IN CHINA. THE CENTRAL GOVERNMENT IS
HAVING DIFFICULTY CONTROLLING THE ECONOMY AND IN PARTICULAR,
REINING IN LOCAL AND PROVINCIAL GOVERNMENT SPENDING AND
INVESTMENT. YANG NOTED THAT CHINESE ECONOMIC POLICYMAKERS
ARE LEARNING THE HARD WAY THAT ENACTING EFFECTIVE
MACROECONOMIC POLICIES IN A MARKET ECONOMY IS VERY TOUGH.
THE POLICYMAKERS ARE ALSO LEARNING THAT PREDICTING SUPPLY
AND DEMAND IN CHINA'S RAPIDLY EXPANDING ECONOMY IS VERY

DIFFICULT. FIVE YEARS AGO ANALYSTS AND POLICYMAKERS ASSUMED 150 MILLION METRIC TONS OF STEEL MAKING CAPACITY WAS SUFFICIENT TO MEET CHINA'S DEMAND, BUT THAT FIGURE IS NOT EVEN ONE HALF OF TODAY'S REAL DEMAND.

¶16. (SBU) YANG ACKNOWLEDGED THAT THERE HAS BEEN PERIODIC OVERCAPACITY IN THE CHINESE STEEL SECTOR IN THE PAST. DESPITE THIS FACT, THE NEXT COUPLE OF YEARS OF EXCESS STEEL PRODUCTION CAPACITY SHOULD BE VIEWED AS AN OPPORTUNITY RATHER THAN A PROBLEM. FOR EXAMPLE, STRUCTURAL REFORMS OF THE SECTOR THROUGH MERGER AND ACQUISITION ACTIVITIES AND TECHNOLOGY UPGRADES CAN ONLY BE DONE DURING SUCH PERIODS OF EXCESS CAPACITY. YANG STATED THAT THE CENTRAL GOVERNMENT SHOULD TAKE ADVANTAGE OF THIS OPPORTUNITY TO ENCOURAGE THE ADAPTATION OF TECHNOLOGIES THAT PROMOTE ENERGY EFFICIENCY AND ENVIRONMENTAL PROTECTION AND TO FACILITATE THE GROWTH OF INTERNATIONALLY COMPETITIVE STEEL ENTERPRISES. THE CENTRAL GOVERNMENT WILL FACE AN UPHILL BATTLE IN DOING THIS BECAUSE APPROVAL AT MULTIPLE GOVERNMENT LEVELS IS REQUIRED FOR THESE EFFORTS, AND MANY LOCAL GOVERNMENTS HAVE SPHERES OF INFLUENCE THEY WANT TO PROTECT THAT SUCH INITIATIVES COULD CHALLENGE.

OVERCAPACITY, OR NOT, PLANNERS HAVE TOUGH ROW TO HOE

¶17. (SBU) CASS' DR. LU STATED THAT GIVEN THE OBSTACLES ARRAYED AGAINST THE OVERCAPACITY CONTROL EFFORTS, THE CENTRAL GOVERNMENT NEEDS TO FORM AN OVERCAPACITY LEADING GROUP SIMILAR TO THE ONE THAT MANAGES ENERGY POLICY. THIS STEP SHOULD BE TAKEN SOON GIVEN THE CENTRAL GOVERNMENT'S

BEIJING 00012549 005 OF 005

GOAL OF
OVERCAPACITY REDUCTION HELPING THE COUNTRY MEET ITS ENERGY CONSERVATION GOALS, AS OUTLINED BY THE ELEVENTH FIVE YEAR PLAN. DR. LU STATED THAT THIS MEANS THAT IF REGULATIONS TO REDUCE OVERCAPACITY ARE GOING TO CONTRIBUTE TO THIS EFFORT, THEY MUST BE YIELDING RESULTS BY 2006 OR 2007. DESPITE THIS APPROACHING DEADLINE, THERE IS NOT YET A CLEAR, DEFINED SEQUENCING SCHEDULE FOR EFFORTS TO REDUCE OVERCAPACITY, ACCORDING TO DR. LU.

¶18. (SBU) THE DRC'S DR. SHI NOTED THAT CENTRAL GOVERNMENT PLANNERS MUST ACCELERATE THEIR UNDERSTANDING OF HOW TO EMPLOY THE ECONOMIC, LEGAL, AND ADMINISTRATIVE TOOLS AT THEIR DISPOSAL TO ADDRESS OVERCAPACITY. HISTORICALLY, CHINESE ECONOMIC PLANNERS RELIED SOLELY ON ADMINISTRATIVE MEASURES TO MAKE ADJUSTMENTS IN THE COMMAND ECONOMY. SUCH A PRACTICE IS INADEQUATE IN CHINA'S CURRENT ECONOMY. OVER THE LONG TERM, DR. SHI STATED THAT CHINA MUST DEVELOP ITS CORPORATE GOVERNANCE ARRANGEMENTS, INDUSTRIAL RELATIONS SYSTEMS, AND OTHER INSTITUTIONS IF IT WANTS TO DEAL WITH PERIODS OF INDUSTRIAL OVERCAPACITY IN A COHERENT FASHION. ABSENT SUCH MATURATION, CHINESE PLANNERS WILL PROBABLY FIGHT AN UPHILL BATTLE TO CREATE A BALANCED INDUSTRIAL STRUCTURE.

RANDT